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August 16, 2004

VIA HAND DELIVERY

Pat Miller, Chairman
Tennessee Regulatory Authority
460 James Robertson Parkway
Nashville, TN 37219

Re: Petition of Chattanooga Gas Company for Approval of Adjustment
of its Rates and Charges and Revised Tariff
Docket Number 04-00034
Rebuttal Testimony of Chattanooga Gas Company

Dear Chairman Miller:

Enclosed you will find the original and fourteen copies of the rebuttal testimony of Chattanooga Gas Company. This filing includes testimony from Steve Lindsey, Mike Morley, Richard Lonn, Dr. Roger A. Morin, Darilyn Jones and Doug Schantz.

Sincerely,



D. Billye Sanders
Attorney for Chattanooga Gas Company

DBS/hmd
Enclosures

cc: Archie Hickerson
Steve Lindsey
John Ebert, Esq.
Elizabeth Wade, Esq.


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Pat Miller, Chairman
August 16, 2004
Page 2

CERTIFICATE OF SERVICE

I hereby certify that on this 16th day of August 2004, a true and correct copy of the enclosed rebuttal testimony was delivered by hand delivery, email, facsimile or U.S. mail postage prepaid to the other Counsel of Record listed below.


D. Billye Sanders, Esq.

Pat Miller, Chairman
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Page 3

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**BEFORE THE
TENNESSEE REGULATORY AUTHORITY**

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**REBUTTAL TESTIMONY
OF
DOUG SCHANTZ**

12 **Q. Please state your name and business address.**

13 A My name is Doug Schantz, and my business address is 1200 Smith Street, Suite
14 900, Houston, Texas 77002.

15 **Q. What is your position with AGL Resources?**

16 A. I am President of Sequent Energy Management, LP ("SEM"), which is a
17 subsidiary of AGLR.

18 **Q. Please provide a summary of your background and professional experience.**

19 A. I joined SEM and was named president in May 2003. I lead all aspects of SEM's
20 operations, including natural gas asset management, supply and distribution,
21 marketing, trading and producer services. I also play a key role in developing and
22 implementing long-term growth and business expansion plans for SEM. I have
23 over 20 years experience in the energy industry and natural gas markets, most
24 recently with Houston-based Cinergy Marketing and Trading, a subsidiary of
25 Cinergy Corp. At Cinergy, I held the position of vice president-marketing and
26 business development, where I was responsible for developing and implementing
27 market strategies and completing business development transactions enabling
28 Cinergy to expand its role in the natural gas industry.

1 Before joining Cinergy, I was executive vice president and general manager for
2 KM Marketing, L P., a subsidiary of Kinder-Morgan Inc., where I helped build
3 the subsidiary into a top-10 North American natural gas marketing and trading
4 company. I have also served in senior management positions with Tenneco
5 Energy Company and Transco Energy Company.

6 I am a graduate of the University of Virginia and hold a master's degree in
7 business administration with a concentration in finance from The University of
8 Chicago.

9 **Q. What is the purpose of your testimony in this proceeding?**

10 A I will respond to the direct filed testimonies of Mr. Daniel McCormac, CPA, and
11 Dr Steve Brown. Specifically, I will respond to these witnesses' assertions that
12 SEM's management of CGC's assets has caused CGC to incur a net loss. At the
13 outset, I would like to emphasize that SEM's employees are very experienced and
14 dedicated to extracting the maximum value out of CGC's idle capacity assets for
15 the benefit of CGC's ratepayers. The energy industry has gone through much
16 turmoil over the last few years, but SEM has consistently delivered material
17 results under this arrangement. SEM has every incentive to continue to provide
18 these benefits now and into the future.

19 **Q. Please explain the asset management arrangement between SEM and CGC.**

20 A. Under the arrangement, CGC assigns its capacity assets to SEM and SEM, as
21 agent for CGC, attempts to generate profits by using the assets to make non-
22 jurisdictional sales when the assets are not needed to serve CGC's firm customers.

23 **Q. Does this arrangement comply with CGC's tariff?**

1 A. Yes. Under CGC's Interruptible Margin Credit Rider ("IMCR") tariff provision
2 approved June 16, 2003, CGC may make non-jurisdictional sales using its assets
3 as long as it shares 50% of the gross profit margin from such sales with its
4 ratepayers. In accordance with this provision, SEM returns fifty percent of the
5 gross profit margin it generates using CGC's assets to CGC for sharing with
6 CGC's ratepayers.

7 **Q. Do you agree with Mr. McCormac's and Dr. Brown's allegations that this**
8 **arrangement imposes losses on CGC?**

9 A No. In fact, it is quite the opposite. SEM is able to manage CGC's idle capacity
10 assets in order to generate material profits for sharing with CGC's ratepayers.
11 SEM's longer-term relationship and knowledge of these assets and third-party
12 suppliers and markets have been a tremendous benefit.

13 **Q. Does your management of these assets cause CGC to incur any incremental**
14 **or unnecessary costs?**

15 A. No. We manage the assets that CGC is already paying for, but are not needed to
16 serve firm customers. In other words, CGC would incur the same fixed costs
17 regardless of whether we, or anyone else, manages these assets. SEM bears most
18 of the costs and risks of generating profits for CGC's ratepayers.

19 **Q. Why would CGC have assets that are not needed for firm customers?**

20 A Due to the nature of capacity planning, CGC must retain enough assets to ensure
21 that it can serve its firm customers on the coldest day of the year. Sometimes,
22 some of this capacity is not needed to serve firm customers. Instead of letting
23 these assets remain idle, SEM looks to the market to capitalize on profitable

1 opportunities. In the case of idle transport, SEM will purchase the supply and
2 transport the gas to sell to markets other than CGC. In the case of idle storage,
3 SEM will borrow and later replace the inventory in the ground. To accomplish
4 this, SEM will sell the supplies to markets other than CGC and use financial
5 derivatives to hedge the replacement cost of the inventory. I must emphasize that
6 SEM only uses the assets when and if CGC is not using them. Further, as more
7 fully explained in the rebuttal testimony of Darlyn Jones, SEM only enters into
8 transactions that will result in an over-all gain for sharing with CGC's ratepayers.

9 **Q Dr. Brown insinuates that SEM causes CGC to contract for capacity that it**
10 **does not need so that SEM will have more assets to manage. Is this true?**

11 **A** Absolutely not. SEM does not play any role in CGC's capacity planning. That
12 function is performed by AGL Services Company's Capacity Planning Group in
13 Atlanta, Georgia that is completely separated from SEM.

14 **Q. Why couldn't CGC manage its own assets?**

15 First, CGC does not have an organization qualified to analyze the market and
16 generate the most profits. Second, I believe it would not be optimal for CGC to
17 build an organization and make significant investments in specialized systems and
18 processes that would more than offset the profits generated by the contemplated
19 transactions. And third, CGC would be incrementally-exposed to much credit risk
20 that would dwarf any potential profits here.

21 **Q. Please elaborate on the scope of SEM's operations that support the**
22 **arrangement with CGC.**

1 A SEM currently sells natural gas to 128 different companies across many pipelines
2 in the eastern half of the United States. To do this, we have an organization of
3 over 80 people involved in the following functions: trading, risk management,
4 credit, scheduling, contract administration, information systems, producer
5 activities, transport and exchange, and asset management. The trading and
6 marketing of natural gas are a very risky and is a people/systems intensive
7 exercise. The industry is full of bankrupt and un-healthy companies who have
8 mismanaged their business.

9
10 In addition, SEM has continually upgraded and expanded its organization with
11 highly experienced personnel and “cutting edge” systems and processes. In fact,
12 SEM is currently in the final phases of implementing a new end-to-end system
13 that will cost SEM close to \$ 10 MM. I strongly believe that SEM is the best asset
14 manager in the industry and serves CGC’s ratepayers very efficiently. Under the
15 current arrangement, CGC’s ratepayers are able to enjoy the benefits of this
16 expertise and these systems and processes *without CGC having to incur the costs*
17 *that would ultimately be passed on to ratepayers.*

18 **Q. Mr. McCormac believes that the amount of revenue generated in 2003 should**
19 **be credited against base rates and used to calculate CGC’s revenue**
20 **requirement on a going forward basis. Do you believe that this is**
21 **appropriate?**

22 A. No. That would mean that SEM was providing the service without the
23 opportunity to generate revenue to offset the costs of transacting the business. I

1 do not know of any asset manager that would provide such a service under such
2 circumstances. Moreover, due to the volatility of the market, one year's profits is
3 not necessarily an indicator of what will occur in the future. The amount and
4 value of the idle assets can be substantially lower if the alternative demand for the
5 assets is lower than in 2003.

6 **Q. Do you have any examples of what asset managers usually require to provide**
7 **this service?**

8 A Yes. SEM currently manages the assets of both Virginia Natural Gas, Inc. and
9 Atlanta Gas Light Company pursuant to asset management agreements. Under
10 those arrangements, SEM retains approximately 50% of the profits generated
11 through managing the assets. Both of these arrangements have been reviewed and
12 approved by the state regulatory agencies regulating those operations. SEM also
13 manages assets for non-affiliated local distribution companies, municipalities, and
14 industrial customers. The arrangements range from profit-sharing to fixed fee
15 payments but always provide the opportunity to generate revenues to offset the
16 costs of doing the business.

17 **Q. Mr. Schantz, do you have an opinion as to what would happen if the TRA**
18 **orders SEM to return all of the profits to CGC for crediting against base**
19 **rates?**

20 Yes. SEM would no longer be able to provide this service. SEM would be forced
21 to divert its resources to other business that would generate revenue to cover our
22 costs. Further, I cannot imagine that any other asset manager would provide this
23 service without an opportunity to generate revenue. As previously discussed,

1 CGC does not have the resources or ability to perform this function. Therefore,
2 CGC would have two options: (1) it could re-create a merchant marketing and
3 trading function within its organization which would create additional costs that
4 would likely exceed any revenue generated from CGC's management of its assets,
5 or (2) CGC would not create such a function and continue to pay the fixed costs
6 associated with its assets without generating any profits from those assets. In
7 contrast, SEM is able to provide this service to CGC and its ratepayers *at no cost*
8 *or risk to CGC*.

9 Q. **Does this conclude your testimony?**

10 A. Yes.